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## FINAL NOTICE

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To: **Merrill Lynch International ("MLI")**

Firm  
Reference  
Number: 147150

Address: 2 King Edward Street  
London  
EC1A 1HQ

Date: 22 April 2015

### **1. ACTION**

- 1.1. For the reasons given in this notice, the Authority proposes to impose on MLI a financial penalty of £13,285,900.
- 1.2. MLI agreed to settle at an early stage of the Authority's investigation. MLI therefore qualified for a 30% (Stage 1) discount under the Authority's executive settlement procedures. Were it not for this discount, the Authority would have imposed a financial penalty of £18,979,876 on MLI.
- 1.3. The Authority has determined that the metric for Step 2 in DEPP 6.5A.2 for cases involving transaction reporting breaches will increase from £1 to £1.50 per breach. The Authority has determined this is necessary to further improve standards of Transaction Reporting.

## **2. SUMMARY OF REASONS**

2.1. The Authority has decided to take action because MLI has contravened SUP 17.1.4R and SUP 17.4.1 EU by failing to report or to accurately report transactions between November 2007 and November 2014 (the "Relevant Period").

2.2. During the Relevant Period MLI:

- (1) Inaccurately reported 35,034,810 transactions, (all of which should have been reported accurately in accordance with SUP 17.4.1 EU/SUP 17 Annex 1 EU); and
- (2) Failed entirely to report 121,387 transactions (all of which should have been reported in accordance with SUP 17.1.4R).

2.3. In particular:

- (1) Between November 2007 and February 2009 MLI failed to accurately report 4,184,028 agency transactions by incorrectly reporting both counterparty and client as the central counterparty for the market side of transactions, and the client as both counterparty and client for the client side (Breach 1 );
- (2) Between November 2007 and September 2009 MLI failed to accurately report 5,134,826 transactions by inaccurately reporting trade times across three product streams (OTC credit and rate derivatives, listed derivatives and cash equities) (Breach 2);
- (3) Between November 2007 and June 2011 MLI failed to accurately report 9,600,000 transactions by incorrectly identifying the counterparty where MLI routed transactions to its Spanish affiliate Merrill Lynch Capital Markets Espana (MLCME) (Breach 3);
- (4) Between February 2009 and February 2012 MLI failed to accurately report 284,997 transactions by incorrect use of the Buy/Sell indicator (Breach 4);
- (5) Between November 2007 and August 2012 MLI failed to accurately report 1,690,000 transactions by incorrectly

identifying the counterparty. MLI incorrectly mapped 81 exchange member identifiers in its client static data system for transactions on Scandinavian Exchanges (Breach 5);

- (6) Between April 2012 and December 2012 MLI failed to accurately report 3,993,383 transactions by omitting to report the maturity dates of equity swaps (Breach 6);
- (7) Between November 2011 and July 2013 MLI failed to report 121,387 listed derivative trades (Breach 7);
- (8) Between November 2007 and November 2013 MLI failed to accurately report 4,656,674 transactions by incorrectly identifying the counterparty. MLI reported transactions in the Brazilian market facing the affiliate Banco Merrill Lynch De Investimentos SA (Bco MLSA), whereas the correct counterparty should have been Bovespa exchange member Merrill Lynch SA Corretora de Titulos e Valores Mobiliarios (ML CTVM) (Breach 8);
- (9) Between December 2012 and September 2014 MLI failed to accurately report 1,171,843 transactions by incorrectly reporting the BIC code for transactions on the Warsaw exchange (Breach 9);
- (10) Between November 2007 and November 2014 MLI failed to accurately report 624,509 transactions executed on the Russian Exchange by incorrectly identifying the correct counterparty (Breach 10); and
- (11) Between November 2007 and November 2014 MLI failed to accurately report 3,694,550 transactions by incorrectly identifying the correct counterparty for transactions executed on the US markets. MLI reported transactions to US exchanges rather than to Merrill Lynch Pierce Fenner & Smith (MLPFS) who was acting as broker (Breach 11).

2.4. Accurate and complete transaction reporting is essential to enable the Authority to meet its operational objective of protecting and enhancing the integrity of the United Kingdom financial system. The primary purpose for which the Authority

uses transaction reports is to perform surveillance for and to inform investigations into, market abuse, insider trading and market manipulation and related financial crime.

- 2.5. A transaction report is a data set submitted to the Authority that relates to an individual financial market transaction which includes, but is not limited to, details of the product traded, the firm that undertook the trade, the trade counterparty, any central counterparty, and trade characteristics such as buy/sell identifier, price, time and the quantity concerned.
- 2.6. The Authority considers MLI's failure to report or accurately report transactions to be particularly serious, given that:
  - (1) MLI has been subject to a Final Notice and issued with a Private Warning for transaction reporting breaches;
  - (2) The Authority has consistently communicated to firms the importance of accurate transaction reporting before and during the Relevant Period; and
  - (3) The Authority has publicised a number of Enforcement actions taken in relation to similar failings by other firms.
- 2.7. In determining an appropriate penalty the Authority has paid particular attention to both the importance it attaches to transaction reporting in general, the previous financial penalty imposed on MLI and its compliance history in relation to transaction reporting.
- 2.8. There were a number of less serious breaches reported by MLI during the relevant period. These breaches were considered by the Authority and taken account of in determining the appropriate action.
- 2.9. The Authority has taken into account the resource devoted by MLI to ensuring accurate transaction reporting and remediating the causes of the failings, including engaging a professional services firm to review internal systems and processes.

### **3. DEFINITIONS**

- 3.1. The definitions below are used in this Final Notice.

"the Act" means the Financial Services and Markets Act 2000.

"the Authority" means the body corporate previously known as the Financial Services Authority and renamed on 1 April 2013 as the Financial Conduct Authority.

"DEPP" means the part of the Authority's handbook entitled "Decision and Procedures and Penalties Manual".

"EEA" means the European Economic Area.

"MiFID" means the Markets in Financial Instruments Directive.

"MLI" means Merrill Lynch International.

"Relevant Period" means the period from November 2007 to November 2014.

"SUP" means the part of the Authority's handbook entitled "Supervision Manual".

"TMU" means the Authority's Transaction Monitoring Unit.

"the Tribunal" means the Upper Tribunal (Tax and Chancery Chamber).

#### **4. FACTS AND MATTERS**

- 4.1. The implementation of MiFID across all EEA member states on 1 November 2007 (effective from 5 November 2007 for transaction reporting) introduced changes to the list of products in which transactions have to be reported and standardised the list of fields which must be included in the reports.
- 4.2. MiFID investment firms entering into reportable transactions are required to comply with SUP 17. MLI is a MiFID investment firm.
- 4.3. SUP 17.1.4R requires such firms which execute transactions to report the details of the transaction to the Authority. Under SUP 17.4.1 EU reports of such transactions must contain the information specified in SUP 17 Annex 1 EU. SUP 17 Annex 1 EU sets out the minimum information required for a transaction report in a table including Field Identifiers and Descriptions.
- 4.4. Both prior to and during the Relevant Period the Authority issued several communications on transaction reporting, including Transaction Reporting Forums for investment firms, the Transaction Reporting User Pack, several Market Watch articles and a transaction reporting library on the Authority's website. The Authority also made available to firms a facility to enable them to regularly review the accuracy of their reports by requesting samples of data they had submitted to the Authority. The Authority has encouraged firms to use this facility by raising awareness of it at Transaction Reporting Forums and publishing reminders in Market Watch newsletters.

- 4.5. During the Relevant Period the Authority published Final Notices and imposed financial penalties in respect of eleven firms for transaction reporting failures.
- 4.6. MLI has been subject to a previous Enforcement action and a Private Warning for transaction reporting failures as follows:
- (1) On 7 November 2002 MLI was issued a Private Warning by the Authority for failing to report 300,000 transactions pursuant to SUP 17; and
  - (2) On 4 August 2006 a Final Notice was published against MLI, fining the firm £150,000 for inaccurately reporting 1,200,000 non-UK European equity transactions from the client's rather than the firm's capacity.
- 4.7. In April 2008 the Authority identified and notified MLI of the transaction reporting breach referred to in this Warning Notice as Breach 1.
- 4.8. In October 2009 MLI notified the Authority of the transaction reporting breach referred to in this Warning Notice as Breach 2.
- 4.9. On 6 August 2010 the Authority's Supervision Division sent a letter to MLI expressing concern about the number of transaction reporting errors identified, and requesting that the firm undertake further work to enhance transaction reporting systems and controls. The firm responded on 6 September 2010, detailing work undertaken, in progress and planned. Work undertaken included system upgrades and remediation of inaccurate trade time reporting. Work in progress included monitoring of these upgrades and an expansion of training. Work planned included thematic reviews and a risk-based system-by-system and field-by-field assessment of cash equity reporting.
- 4.10. Between June and December 2011 MLI notified the Authority of the transaction reporting breaches referred to in this Warning Notice as Breaches 3 and 4.
- 4.11. On 9 May 2012, the Authority's TMU carried out a visit to MLI as part of its Firm Visit Programme.
- 4.12. In August and November 2012 MLI notified the Authority of the transaction reporting breaches referred to in this Warning Notice as Breaches 5 and 6.
- 4.13. On 20 February 2013 the Authority's TMU sent the firm a report of its findings from the visit of 9 May 2012, setting out required remediation.

- 4.14. In April 2013 MLI notified the Authority of the transaction reporting breach referred to in this Warning Notice as Breach 7.
- 4.15. On 24 June 2013 the Authority wrote again to MLI expressing concern that despite continuing failings, *"...it appears [to the Authority] that the Firm has not carried out effective remediation work to prevent further failings occurring."* The letter expressed concern that some of the recent failings were similar to those outlined in the Final Notice of August 2006. The firm responded on 19 July 2013, identifying *"further possible areas of improvement to build on our existing operational infrastructure and governance framework."*
- 4.16. In September 2013 MLI instructed a professional services firm to assist in certain aspects of the remedial work, specifically to:
- (1) review MLI's transaction reporting matrix;
  - (2) review MLI's testing methodology; and
  - (3) assist in creating a new quality control team.
- 4.17. MLI provided monthly updates of the remediation work to the Authority. This work was completed in October 2014.
- 4.18. In February 2014 MLI notified the Authority of the transaction reporting breach referred to in this Warning Notice as Breach 8.
- 4.19. In September 2014, as part of the work it was undertaking with the professional services firm, MLI notified the Authority of the transaction reporting breach referred to in this Warning Notice as Breach 9.
- 4.20. In October 2014 MLI notified the Authority of the transaction reporting breach referred to in this Warning Notice as Breach 10.
- 4.21. In November 2014 MLI notified the Authority of the transaction reporting breaches referred to in this Warning Notice as Breach 11.

## **5. FAILINGS**

- 5.1. Section 206 of the Act gives the Authority the power to impose a penalty on an authorised firm if that firm has contravened a requirement imposed on it by or under the Act or by any directly applicable European Community regulation or decision made under MiFID.

- 5.2. The Authority considers that MLI has breached SUP 17.1.4R and SUP 17.4.1 EU which respectively state:

*"A firm which executes a transaction:*

*(1) in any financial instrument admitted to trading on a regulated market or a prescribed market (whether or not the transaction was carried out on such a market); or*

*(2) in any OTC derivative the value of which is derived from, or which is otherwise dependent upon, an equity or debt-related financial instrument which is admitted to trading on a regulated market or on a prescribed market;*

*must report the details of the transaction to the Authority"*

- 5.3. By failing entirely to report 121,387 transactions, MLI breached its obligations under SUP 17.14R.

- 5.4. SUP 17.4.1 EU states:

*"Reports of transactions made in accordance with Articles 25(3) and (5) of MiFID shall contain the information specified in SUP 17 Annex 1 EU which is relevant to the type of financial instrument in question and which the FCA declares is not already in its possession or is not available to it by other means."*

- 5.5. SUP 17 Annex 1 EU sets out the minimum content of a transaction report including Field Identifiers and Descriptions.

- 5.6. 35,034,810 of the transactions that MLI executed in the Relevant Period were reported incorrectly in breach of its obligations under SUP 17.4.1EU as the data contained was not in the format required by SUP 17 Annex 1 EU.

## **6. SANCTION**

### **Financial Penalty**

- 6.1. The conduct at issue occurred both before and after 6 March 2010. As set out in paragraph 2.7 of the Authority's Policy Statement 10/4, when calculating a financial penalty where conduct spans both regimes, the Authority must have regard to both the penalty regime which was effective before 6 March 2010

("the Old Penalty Regime") and the penalty regime that was effective on and after 6 March 2010 ("the New Penalty Regime").

6.2. The Authority has adopted the following approach in this case:

- (1) Calculated the financial penalty for MLI's misconduct from 5 November 2007 until and including 5 March 2010 by applying the Old Penalty Regime to that misconduct;
- (2) Calculated the financial penalty for MLI's misconduct from 6 March 2010 until November 2014 by applying the New Penalty Regime to that misconduct; and
- (3) Added the penalties under (1) and (2) above to determine the total penalty over the course of the Relevant Period.

6.3. For the purposes of establishing penalty figures applicable to the misconduct falling within the old and new regimes, the Authority has determined the number of reportable transactions that were inaccurately reported or not reported both before and after 6 March 2010 set out in the following table:

<b>Breach No.</b>	<b>Old Regime</b>	<b>New Regime</b>
1	4,184,028	N/A
2	5,134,826	N/A
3	6,109,091	3,490,909
4	100,134	184,863
5	815,862	874,138
6	N/A	3,993,383
7	N/A	121,387
8	1,715,617	2,941,057
9	N/A	1,171,843
10	205,721	418,788
11	1,217,028	2,477,522
<b>Total under each regime</b>	<b>19,482,307</b>	<b>15,673,890</b>
<b>Grand total</b>	<b>35,156,197</b>	

6.4. The combined total of the inaccurate or absent transaction reports is 35,156,197.

#### **Financial Penalty under the Old Penalty Regime**

6.5. The Authority's policy on the imposition of financial penalties relevant to the misconduct prior to 6 March 2010 is set out in the version of Chapter 6 of DEPP that was in force prior to 6 March 2010. For the purposes of calculating the

penalty under the Old Penalty Regime in respect of the transaction reporting failures between November 2007 and 5 March 2010, the Authority has considered the factors set out below.

*Deterrence (DEPP 6.5.2 G (1))*

- 6.6. The principal purpose of imposing a financial penalty is to promote high standards of regulatory and market conduct. The Authority considers that a penalty of the amount proposed below will deter it and other firms from committing similar breaches.
- 6.7. The Authority considers that the penalty will reinforce generally to other firms the importance of accurate transaction reporting to the orderly conduct of markets in the UK and wider Europe.

*Seriousness and Impact (DEPP 6.5.2 G (2))*

- 6.8. MLI's transaction reporting failures continued over an extensive period of time and affected several asset classes and business lines.
- 6.9. MLI's failure to submit accurate transaction reports had the potential to hinder the Authority's ability to detect and investigate suspected incidences of market abuse, insider trading and market manipulation.
- 6.10. Given MLI's size and the high volume of transactions that it failed to report or to report accurately, the potential impact of the failures in this case was significant.

*Deliberate or Reckless (DEPP 6.5.2 G (3))*

- 6.11. The Authority does not consider that MLI's conduct was deliberate or reckless.

*Financial Resources (DEPP 6.5.2 G (5))*

- 6.12. Given MLI's size, the Authority considers that it has sufficient financial resources to pay a penalty of the level proposed.

*Benefit Gained / Loss Avoided (DEPP 6.5.2 G (6))*

- 6.13. MLI did not profit from the inaccurate transaction reporting.

*Conduct following the breaches (DEPP 6.5.2 G (8))*

- 6.14. MLI committed resources to remediate the causes of the failings, including engaging an assurance and advisory firm to review internal systems and

processes in 2013. The professional services firm provided further advice on improving systems to ensure transaction reporting was compliant with SUP 17.

*Disciplinary Record and Compliance History (DEPP 6.5.2 G (9))*

- 6.15. MLI received a Private Warning from the Authority in November 2002 in respect of transaction reporting. Further, the Authority issued MLI with a Final Notice and fine of £150,000 in August 2006 for transaction reporting failures.

*Authority guidance and other published materials (DEPP 6.5.2 G (12))*

- 6.16. Prior to and during the Relevant Period the Authority published several communications on transaction reporting, including Transaction Reporting Forums for investment firms, the Transaction Reporting User Pack, Market Watch Articles and a transaction reporting library on the Authority's website. The Authority also made available to firms a facility to enable them to regularly review their transaction data by requesting a sample of the data that they had submitted to the Authority.

*Old Penalty Regime Penalty*

- 6.17. The total number of transactions falling within the Old Penalty Regime is 19,482,307. Applying these factors, and in particular, the disciplinary history of MLI, the Authority considers the appropriate level of penalty to be imposed under the Old Penalty Regime to be £8,400,000.
- 6.18. Following the application of the discount for Stage 1 Settlement the penalty to be imposed under the old regime is £5,880,000.

**Financial penalty under the New Penalty Regime**

- 6.19. Under the New Penalty Regime the Authority applies a five step framework to determine the appropriate level of financial penalty. DEPP 6.5A sets out the details of this process that applies in respect of financial penalties imposed on firms. The total number of transactions falling within the New Penalty Regime is 15,673,890.

*Step 1: Disgorgement (DEPP 6.5A.1)*

- 6.20. MLI did not benefit financially from the breaches, and therefore for the purposes of Step 1, DEPP 6.5A.1, the figure is £0.

Step 2: The seriousness of the breach (DEPP 6.5A.2)

- 6.21. For the purpose of Step 2, DEPP 6.5A.2, the Authority considers that the number of misreported or non-reported transactions is an appropriate indicator of the harm or potential harm caused. The Authority has determined the appropriate basis figure at Step 2 to be £23,510,835, by attributing a value of £1.50 to each of MLI's reportable transactions in breach of SUP 17 during the part of the Relevant Period covered by the New Penalty Regime.
- 6.22. The Authority has given substantial and ongoing guidance to the industry regarding Transaction Reporting requirements through Market Watch, and various tools have been provided to facilitate compliance. Despite the imposition of 11 fines since MiFID industry standards have not improved to a sufficiently high standard. The Authority regards that the previous metric of £1 per breach is not generating fines sufficient to achieve the goals of credible deterrence. The Authority considers that this increase in the Step 2 metric to £1.50 is necessary to increase standards throughout the industry.
- 6.23. The Authority has determined the seriousness of MLI's breaches to be Level 4 for the purposes of Step 2, having taken into account:
- (1) DEPP 6.5A.2G (6-9) which lists factors the Authority will generally take into account in deciding which level of penalty best indicates the seriousness of the breach;
  - (2) DEPP 6.5A.2G (11) which lists factors likely to be considered 'level 4 or 5 factors'; and
  - (3) DEPP 6.5A.2G (12) which lists factors likely to be considered 'level 1, 2 or 3 factors.'
- 6.24. Of these, the Authority considers the following factors to be relevant:
- (1) The breaches are considered to be serious because they revealed weaknesses in MLI's procedures, management systems and internal controls relating to transaction reporting;
  - (2) The breaches are considered serious as they were multiple, discrete events which continued, in some cases, for significant time periods before detection and remediation;

- (3) Senior management became aware of the post-MiFID breaches in 2010. However, a working group was set up which failed fully to address these issues;
- (4) MLI did not make any profit or avoid any loss as a result of the breaches;
- (5) There was no loss to consumers, investors, or other market users;
- (6) There was no potential significant effect on market confidence; and
- (7) There is no evidence that the breach was committed deliberately or recklessly.

6.25. The Authority has applied the following percentages to the seriousness factors considered at DEPP 6.5A.2 (3):

- (1) level 1 – 0%
- (2) level 2 - 10%
- (3) level 3 – 20%
- (4) level 4 – 30%
- (5) level 5 – 40%

6.26. The penalty calculation is therefore 30% of £23,510,835. The penalty figure after Step 2 is therefore £7,053,250.

*Step 3: Mitigating and aggravating factors (DEPP 6.5A.3)*

6.27. At Step 3 the Authority may increase or decrease the amount of financial penalty arrived at after Step 2 in order to take account of any mitigating or aggravating factors.

6.28. The Authority considers that the following factors aggravate the breaches:

- (1) The Authority had previously issued MLI with both a Private Warning and a Final Notice in respect of transaction reporting failures. The breaches relating to both the Private Warning and the Final Notice were similar in nature to the present breaches;

- (2) The Authority has provided a significant amount of guidance to firms on how to report transactions, as well as providing firms with a facility to check those reports;
- (3) The Authority published, both before and during the Relevant Period, a number of Final Notices in relation to transaction reporting;
- (4) The Authority informed MLI of ongoing concerns regarding its compliance with SUP 17 on several occasions during the Relevant Period;
- (5) Attempts at remediation failed to identify several further breaches, some of which were both prolonged and similar in nature to previous breaches; and
- (6) The working group set up with the responsibility for ensuring the accuracy of transaction reporting did not fully identify and remediate all issues.

6.29. The Authority considers that the following factors mitigate the breaches:

- (1) MLI introduced a working group with the responsibility of ensuring the accuracy of transaction reporting. During the relevant period the group was expanded to include senior members of the organisation;
- (2) MLI devoted resource to ensure accurate transaction reporting and remediating the causes of the failings, including engaging a professional services firm to review internal systems and processes in 2013;
- (3) MLI self-reported ten of the eleven breaches; and
- (4) MLI has cooperated fully with the Authority.

6.30. Taking into account all the aggravating and mitigating factors listed above the Authority considers an increase of 50% to the figure calculated by Step 2 to be appropriate. When considering the percentage increase at Step 3, the Authority has had particular regard to MLI's failure to achieve acceptable standards of transaction reporting despite being subject to a previous Enforcement action and

a Private Warning for similar breaches, and to letters the firm received from the Authority highlighting its concern about MLI's non-compliance in this area.

The figure after Step 3 is therefore £10,579,875.

Step 4: Adjustment for Deterrence (DEPP 6.5A.4)

- 6.31. If the penalty figure arrived at after Step 3 is not considered by the Authority to be sufficient to deter the firm which committed the breaches, or other firms, from committing further or similar breaches, in accordance with DEPP 6.5A.4 the Authority may increase that penalty.
- 6.32. The authority considers that the penalty figure at Step 3 is sufficient to achieve deterrence. The penalty figure at Step 4 is therefore £10,579,875.

Step 5: Settlement Discount (DEPP 6.5A.5)

- 6.33. Pursuant to DEPP 6.5A.5, if the Authority and the firm on whom a penalty is to be imposed agree the amount of the financial penalty and other terms, DEPP 6.7 provides that the amount of the financial penalty which might otherwise have been payable will be reduced to reflect the stage at which the Authority and the firm reached agreement.
- 6.34. The Authority and MLI reached agreement at Stage 1 and so a 30% discount applies to the Step 4 figure.

The penalty figure under the new regime after Step 5 is therefore £7,405,912.

**Penalty**

- 6.35. The Authority considers that combining the two separate penalties calculated under the old and new penalty regimes produces a figure which is proportionate and consistent with the Authority's statements that the new penalty regime may lead to increased penalty levels. The Authority therefore imposes on MLI a financial penalty of £13,285,900 (after Stage 1 Settlement Discount and rounding down to the nearest £100) for breaching SUP 17.4.1 EU.

**7. PROCEDURAL MATTERS**

**Decision maker**

- 7.1. The decision which gave rise to the obligation to give this Notice was made by the Settlement Decision Makers.

7.2. This Final Notice is given under, and in accordance with, section 390 of the Act.

**Manner of and time for Payment**

7.3. The financial penalty must be paid in full by MLI to the Authority by no later than 6 May 2015, 14 days from the date of the Final Notice.

**If the financial penalty is not paid**

7.4. If all or any of the financial penalty is outstanding on 7 May 2015, the Authority may recover the outstanding amount as a debt owed by MLI and due to the Authority.

**Publicity**

7.5. Sections 391(4), 391(6) and 391(7) of the Act apply to the publication of information about the matter to which this notice relates. Under those provisions, the Authority must publish such information about the matter to which this notice relates as the Authority considers appropriate. The information may be published in such manner as the Authority considers appropriate. However, the Authority may not publish information if such publication would, in the opinion of the Authority, be unfair to you or prejudicial to the interests of consumers or detrimental to the stability of the UK financial system.

7.6. The Authority intends to publish such information about the matter to which this Final Notice relates as it considers appropriate.

**Authority contacts**

7.7. For more information concerning this matter generally, contact Evan Benge (direct line: 020 7066 1660 /fax: 020 7066 1661) or Sairah Ahmed (direct line: 0207 066 4508 /fax: 0207 066 4509) of the Enforcement and Market Oversight Division of the Authority.

Mario Theodosiou

Project Sponsor

Financial Conduct Authority, Enforcement and Market Oversight Division